

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING #00-10**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Application of Tennessee's franchise, excise and income tax statutes to a limited partnership that owns stock in a Tennessee corporation.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER], a Tennessee limited partnership, will own stock in a corporation incorporated under the laws of Tennessee and doing business in Tennessee. The Tennessee corporation will be subject to and will pay Tennessee's franchise and excise taxes. It is contemplated that [TAXPAYER] will receive dividends from the Tennessee corporation. It is also contemplated that [TAXPAYER] will make distributions to its partners from the dividends [TAXPAYER] receives. The distributions will not include

interest on any debt between any partner and the limited partnership and there will be no instrument(s) evidencing any indebtedness between the limited partnership and the partners. The partners of [TAXPAYER] will execute a partnership agreement but will not hold any certificate or other instrument representing their ownership interest in [TAXPAYER].

QUESTIONS

1. Will [TAXPAYER] owe any franchise tax on the value of stock it owns in the Tennessee corporation that is paying the franchise tax?
2. Will [TAXPAYER] owe any excise tax on dividend income received by [TAXPAYER] which is subject to the Tennessee income tax?
3. Will the partners of [TAXPAYER] owe any Tennessee Hall income tax on any allocations or distributions of profits they receive from [TAXPAYER] when the partners will hold no certificates representing their ownership of a partnership interest in [TAXPAYER]?

RULINGS

1. While [TAXPAYER] will be subject to franchise tax liability, it will be allowed a deduction from net worth to the extent of the value of its ownership interest in the Tennessee corporation.
2. While the dividend income received by [TAXPAYER] will be subject to excise tax liability, [TAXPAYER] will be allowed a credit against that liability in an amount equal to the Tennessee Hall income tax imposed upon and paid by [TAXPAYER].
3. No.

ANALYSIS

1. [TAXPAYER] WILL BE ALLOWED A DEDUCTION FROM THE NET WORTH FRANCHISE TAX MEASURE FOR THE VALUE OF ITS INVESTMENT IN THE TENNESSEE CORPORATION.

Doing business in Tennessee is a taxable privilege. T.C.A. § 67-4-2104 provides as follows:

Doing business in Tennessee by any person or taxpayer, and/or exercising the corporate franchise, are hereby declared to be taxable privileges. The tax is an accrued tax and is imposed for the exercise of the specified privilege during the period that coincides with the tax year covered by the return required.

T.C.A. § 67-4-2004 defines a “person” or “taxpayer” as follows:

“Person” or “taxpayer” means every corporation, subchapter S corporation, limited liability company, professional limited liability company, registered limited liability partnership, limited partnership,

Thus, in accordance with T.C.A. §§ 67-4-2104 and 67-4-2004, a limited partnership is subject to Tennessee’s franchise tax.

Tennessee’s franchise tax is imposed on the greater of the taxpayer’s net worth under T.C.A. § 67-4-2106, or the book value (cost less depreciation) of property owned or used in Tennessee under T.C.A. § 67-4-2108.

With respect to imposition of the franchise tax when net worth is the base, T.C.A. § 67-4-2106 provides as follows:

- (a) The privilege tax hereby imposed on all taxpayers shall be a tax of twenty-five cents (25¢) per one hundred dollars (\$100), or major fraction thereof, of a taxpayer’s net worth, determined in accordance with generally accepted accounting principles, at the close of the tax year covered by the required return.
- (b) For purposes of this section, “net worth” means the difference between the value of a taxpayer’s total assets less its total liabilities determined in accordance with generally accepted accounting principles for the tax year covered by the return. Proper reductions of asset and liability accounts used to determine net worth for franchise tax purposes will be allowed if they are in accordance with generally accepted accounting principles. Treasury stock shall not be considered a part of net worth of a corporation.

With respect to imposition of Tennessee’s franchise tax when the book value of Tennessee property owned or used is the tax base, T.C.A. 67-4-2108(a)(1) provides as follows:

The measure of the tax hereby imposed shall in no case be less than the actual value of the property owned, or property used, in Tennessee, excluding exempt inventory.

T.C.A. § 67-4-2107(b), however, provides as follows:

The value of an interest, determined in accordance with generally accepted accounting principles, held by the taxpayer in any other taxpayer paying the tax herein levied and actually doing business in this state shall be deducted from the measure of the tax of the first taxpayer.

See also, Tenn. Comp. R. & Regs. 1320-6-1-.39.

Thus, while [TAXPAYER] is clearly subject to paying Tennessee franchise tax, it is allowed a deduction from net worth for the value of its interest in the Tennessee corporation that is also paying the franchise tax. The effect of this deduction on [TAXPAYER]’s franchise tax liability is dependent upon the size of the interest that

[TAXPAYER] holds in the Tennessee corporation and whether its franchise tax base is net worth or the book value of property owned or used in Tennessee.

2. [TAXPAYER] WILL BE ALLOWED A CREDIT AGAINST ITS EXCISE TAX LIABILITY FOR ANY TENNESSEE HALL INCOME TAX IMPOSED UPON AND PAID BY [TAXPAYER].

With respect to the application of Tennessee's excise tax, T.C.A. § 67-4-2007 provides, in pertinent part, as follows:

- (a) All persons, except those having not-for-profit status, doing business in Tennessee, shall, without exception other than as provided herein, pay to the commissioner, annually, an excise tax, in addition to all other taxes, equal to six percent (6%) of the net earnings for the next preceding fiscal year for business done in this state during that fiscal year. Notwithstanding the fact that a person is not-for-profit or otherwise exempted from the excise tax, such person shall be subject to the excise tax on all of its Tennessee net earnings that are attributable to any activities unrelated to and outside the scope of the activities that gave it an exemption status, including all unrelated taxable income as defined in the Internal Revenue Code, § 512.
- (b) Every such person, now or hereafter doing business within this state, shall, as a recompense for the protection of its local activities and as compensation for the benefits it receives from doing business in Tennessee, pay the tax imposed by this part.

As discussed above in the analysis to question 1, T.C.A. § 67-4-2004(16) defines a person or a taxpayer to include a limited partnership. Thus, absent an exemption, every limited partnership that does business in Tennessee will be subject to paying Tennessee's excise tax. Tennessee's excise tax, however, provides for certain credits. See, T.C.A. § 67-4-2009. Of relevance to the question at issue, T.C.A. § 67-4-2009(8) provides as follows:

A credit shall be allowed against the tax imposed by this part in an amount equal to the tax imposed by chapter 2 of this title paid by the taxpayer.

Chapter 2 of title 67 that is referenced in T.C.A. § 67-4-2009(8) is the Tennessee Hall income tax ("Hall Tax") statute. The Hall Tax is an income tax levied on incomes derived by way of dividends from stocks or interest on bonds, persons, partnerships, associations, trusts and corporations. Thus, based upon T.C.A. 67-4-2009(8), [TAXPAYER] will be allowed a credit against its Tennessee excise tax liability equal to the Hall Tax that it pays.

3. THE PARTNERS OF [TAXPAYER] WILL NOT OWE TENNESSEE HALL INCOME TAX ON ANY ALLOCATIONS OR DISTRIBUTIONS OF PROFITS THEY RECEIVE FROM [TAXPAYER].

The modern trend of both the courts and legislative bodies is to treat a partnership as a legal entity separate from its partners for certain purposes. Tax Review Board v.

Belmont Laboratories Company, 141 A.2d 234 at 238 (1958). The Tennessee State Attorney General's office has opined that a partnership should be treated as a separate legal entity in Tennessee for purposes of taxation. Op. Att'y Gen. 83-443 (1983). Thus, a partnership is considered a legal entity separate from its partners for purposes of the Tennessee income tax.

With respect to the Hall Tax, T.C.A. § 67-2-102 provides as follows:

An income tax in the amount of six percent (6%) per annum shall be levied and collected on incomes derived by way of dividends from stocks or by way of interest on bonds of each person, partnership, association, trust and corporation in the state of Tennessee who received, or to whom accrued, or to whom was credited during any year income from the sources above enumerated, except as hereinafter provided.

While dividend and interest income is subject to the Hall Tax, the allocations or distributions of profit that the partners receive will not be subject to the tax because those allocations or distributions will not be considered income derived by way of dividends from stocks or interest on bonds as contemplated by T.C.A. § 67-2-102. The distributions are not income derived by way of dividends from stocks or interest on bonds because there is no instrument evidencing an indebtedness as required by T.C.A. § 67-2-101(1) and there is no transferable evidence of an interest in the partnership as required by T.C.A. § 67-2-101(6). Since the partnership, however, is a legal entity separate and apart from the partners, the dividend income received by the partnership will be subject to the Hall Tax.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: 4/12/00